



TAX EXEMPT AND  
GOVERNMENT ENTITIES  
DIVISION

DEPARTMENT OF THE TREASURY  
INTERNAL REVENUE SERVICE  
WASHINGTON, D.C. 20224

Release Number: **201317011**

Release Date: 4/26/2013

Date: February 1, 2013

501.00-00

502.03-03

502.00-00

502.01-00

Contact Person:

Identification Number:

Contact Number:

Employer Identification Number:

Form Required To Be Filed:

Tax Years:

Dear

This is our final determination that you do not qualify for exemption from Federal income tax as an organization described in Internal Revenue Code section 501(c)(3). Recently, we sent you a letter in response to your application that proposed an adverse determination. The letter explained the facts, law and rationale, and gave you 30 days to file a protest. Since we did not receive a protest within the requisite 30 days, the proposed adverse determination is now final.

Because you do not qualify for exemption as an organization described in Code section 501(c)(3), donors may not deduct contributions to you under Code section 170. You must file Federal income tax returns on the form and for the years listed above within 30 days of this letter, unless you request an extension of time to file. File the returns in accordance with their instructions, and do not send them to this office. Failure to file the returns timely may result in a penalty.

We will make this letter and our proposed adverse determination letter available for public inspection under Code section 6110, after deleting certain identifying information. Please read the enclosed Notice 437, *Notice of Intention to Disclose*, and review the two attached letters that show our proposed deletions. If you disagree with our proposed deletions, follow the instructions in Notice 437. If you agree with our deletions, you do not need to take any further action.

If you have any questions about this letter, please contact the person whose name and telephone number are shown in the heading of this letter. If you have any questions about your Federal income tax status and responsibilities, please contact IRS Customer Service at

1-800-829-1040 or the IRS Customer Service number for businesses, 1-800-829-4933. The IRS Customer Service number for people with hearing impairments is 1-800-829-4059.

Sincerely,

Holly O. Paz  
Director, Rulings and Agreements

Enclosure  
Notice 437  
Redacted Proposed Adverse Determination Letter  
Redacted Final Adverse Determination Letter



TAX EXEMPT AND  
GOVERNMENT ENTITIES  
DIVISION

DEPARTMENT OF THE TREASURY  
INTERNAL REVENUE SERVICE  
WASHINGTON, D.C. 20224

Date: December 17, 2012

Contact Person:

Identification Number:

Contact Number:

FAX Number:

Employer Identification Number:

501.00-00  
501.03-03  
502.00-00  
502.01-00

**LEGEND**

Country =  
Commission =  
Trustee =  
Manager =  
Declaration =  
Fund =  
Description  
C1 =  
C2 =  
C3 =  
Date 1 =  
X Percent =  
Y Percent =  
U Percent =  
V Percent =

Dear

We have considered your application for recognition of exemption from Federal income tax under § 501(a) of the Internal Revenue Code (Code). Based on the information provided, we have concluded that you do not qualify for exemption under § 501(c)(3). The basis for our conclusion is set forth below.

**FACTS**

You are a trust created on Date 1 as a "common investment fund" by Commission, pursuant to the charities law of Country. Declaration provides that you were formed for the purpose of creating an investment fund to which any charity registered with Commission (each a Registered Charity) may contribute in exchange for investment units. Declaration does not expressly provide that you were created exclusively for charitable purposes within the meaning

of § 501(c)(3). You provided an opinion of legal counsel explaining that an amendment of Declaration to include an appropriate clause stating that you were formed exclusively for charitable purposes within the meaning of § 501(c)(3) would require action by Commission and such action could not easily be accomplished. You assert that your status as a Registered Charity under the laws of Country demonstrates that you are organized for a charitable purpose. Nonetheless, if the grant of exemption would be conditioned solely upon an amendment to Declaration, you would take steps to obtain the necessary amendment.

Declaration vests oversight of your activities in Commission. Under the terms of Declaration, Commission delegates duties and responsibilities among Manager, Trustee and an administrative body independent of Manager and Trustee (Board). Board determines your investment objectives and provides a written statement of those investment objectives to Manager, with a copy to Trustee. Board is responsible for supervising the execution of Trustee's and Manager's respective duties. Manager prepares a written investment policy consistent with the investment objectives set by Board. Manager's written investment policy must address diversification of investments, suitability of investments based upon Board's investment objective, balance among types of investments, risk, expected return and realization of investments. Manager's responsibilities also include preparation of Fund Description, which is an informational guide to investor charities. Trustee maintains custody of your assets, creates and cancels units, executes documents necessary to effect securities transactions as directed by Manager, and oversees the performance of Manager's duties. Trustee advises Commission of any issues regarding Manager's compliance with the terms of Declaration or Manager's performance of its specific investment management duties.

By acquiring units, a Registered Charity may achieve diversification of its financial assets that it might not be able to achieve on its own. In addition, as your investments include U.S. equities, an investor charity can gain access to the U.S. equity market by acquiring units. Manager determines the value of units based upon the value of your assets, after provision is made for expenses and fees paid to Trustee and to Manager. As a result, each investor charity bears a share of expenses and fees in proportion to the number of units it owns.

Under the terms of Declaration, an investor charity is entitled to a copy of Declaration and any amendments thereto, Fund Description, the investment policy statement, reports prepared by Board, Trustee or Manager as required by Declaration, statements of account and any required audit reports. Investor charities do not participate in the selection or removal of Board, Trustee, or Manager. Approval of investor charities is not required for any matters other than a reorganization or dissolution. Questions arising as to the rights of investor charities under Declaration are decided by Trustee.

You state that your sole activity is investment management for the benefit of Registered Charities that contribute funds to you in exchange for investment units. In response to a request for additional information, you expanded upon the description of your activities to include, free training programs and conferences designed to enhance charity managers' ability competently to manage their organizational funds. However, you do not indicate the amount of time devoted to those activities or describe how or by whom they are conducted.

Board, Manager and Trustee are entitled to reimbursement for expenses incurred in connection

with services rendered to you. In addition, Manager and Trustee are each entitled to management and trustee fees, respectively. The fee paid to Manager cannot exceed X Percent per annum. The fee approved by Commission is Y Percent per annum. The fee paid to Trustee cannot exceed U Percent. The fee approved by Commission is V Percent.

You state that the fee paid to Manager is generally set at a rate that will allow Manager to recover its costs; however, the fee is not specifically tied to Manager's costs. Instead, you state that Manager is owned by C1, C2, and C3, each of which is a Registered Charity. To the extent that Manager derives a profit from services rendered to you, those profits exclusively benefit C1, C2, and C3.

You represented that as a foreign organization, you are not subject to Office of Foreign Assets Control (OFAC) rules; however, Country has its own sanctions program and that you comply with those requirements. You further assert that, as you do not make grants or engage in activities outside of Country, checking investor charities' against the sanction list maintained by Country addresses this issue.

You assert that you are not subject to § 508(a) because more than     percent of your receipts are from sources outside the United States. You are nonetheless seeking a determination of exemption under § 501(c)(3) because of a requirement imposed by a transfer agent (as defined in § 7701(a)(16)).

## **LAW**

Section 501(c)(3) provides an exemption from taxation for organizations that are organized and operated exclusively for charitable and educational purposes including for the prevention of cruelty to animals, no part of the net earnings of which inures to the benefit of any private shareholder or individual.

Section 502 provides that "[a]n organization operated for the primary purpose of carrying on a trade or business for profit shall not be exempt from taxation under section 501 on the ground that all of its profits are payable to one or more organizations exempt from taxation under section 501."

Section 508(a) provides that, subject to certain exceptions, in order to be recognized as an organization described in § 501(c)(3), the organization must provide notice to the Secretary of the Treasury. An organization claiming exemption under § 501(c)(3) provides such notice by filing Form 1023.

Section 1.501(c)(3)-1(a) of the Income Tax Regulations provides that in order to be exempt as an organization described in § 501(c)(3), the organization must be one that is both organized and operated exclusively for one or more charitable, educational or other exempt purposes. An organization that fails to meet either the organizational or the operational test is not exempt.

Section 1.501(c)(3)-1(b)(1)(i) provides that an organization is organized exclusively for one or more exempt purposes only if the provisions of its articles of organization limit the purposes of the organization to those exempt purposes and do not expressly empower the organization to

engage (other than to an insubstantial degree) in one or more activities that are not in furtherance of one or more exempt purposes.

Section 1.501(c)(3)-1(b)(2) provides that, in the case of a trust, the term "articles of organization" refers to the trust instrument.

Section 1.501(c)(3)-1(c)(1) provides that an organization will be regarded as being operated exclusively for charitable purposes only if the organization engages primarily in activities which further the accomplishment of an exempt purpose, so long as only an insubstantial part of its activities are not in furtherance of the accomplishment of exempt purposes.

Section 1.508-1(a)(2)(i) provides that an organization seeking exemption under § 501(c)(3) must file the notice described in § 508(a) within 15 months from the end of the month in which the organization was organized... and such notice is filed by submitting a properly completed and executed Form 1023, exemption application.

Section 1.508-1(a)(2)(vi) provides that § 508 does not apply to a foreign organization described in § 4948(b) (which is an organization that has received substantially all of its support from sources outside the United States).

Section 1.508-1(a)(4) provides that any "organization excepted from the requirement of filing notice under § 508(a) will be exempt from taxation under § 501(c)(3) if it meets the requirements of that section, whether or not it files such notice."

In Better Business Bureau of Washington D.C., Inc. v. United States, 326 U.S. 279 (1945), the Supreme Court held that the presence of a single non-exempt purpose, if substantial in nature, will destroy the exemption regardless of the number or importance of truly exempt purposes. The Court found that a trade association had an "underlying commercial motive" that distinguished its educational program from that carried out by a university, and therefore, the association did not qualify for exemption.

In Christian Echoes Nat'l. Ministry, 470 F.2d at 854 (10th Cir. 1972), cert. denied, 414 U.S. 864 (1973), citing Dickinson v. United States, 346 U.S. 389 (1953) it was held that an organization claiming exemption has the burden of establishing its entitlement to exempt status.

In Rev. Rul. 69-528; 1969-2 C.B. 127, it was held that an organization that provided investment management services to charitable organizations seeking a means to diversify their investments did not qualify for exemption under § 501(c)(3). The investing charities had no control over the management of the investments. The organization had absolute and uncontrolled discretion as if it were absolute owner with respect to investments, payment of taxes and liens, and distributions (or accumulation) of income and principal. Investing charities had no power to cause a partition of the fund.

In Rev. Rul. 71-529, 1971-2 C.B. 234, it was held that an organization that assisted member colleges and universities in fund management qualified for exemption under § 501(c)(3). The member organizations controlled the organization through selection of its governing body from among representatives of all member institutions. Member organizations paid only nominal fees

(which were less than cost); substantially all of the organization's expenses were paid by contributions from other charitable organizations. It was held that the applicant achieved a charitable purpose by providing an essential service for charges "substantially below cost."

In Rev. Rul. 72-369, 1972-2 C.B. 245, it was held that an organization formed to provide managerial and consulting services at cost to unrelated exempt organizations did not qualify for exemption under § 501(c)(3). The ruling states, "[p]roviding managerial and consulting services on a regular basis for a fee are a trade or business ordinarily carried on for profit. The fact that the services are provided at cost and solely to exempt organizations is not sufficient to characterize this activity as charitable within the meaning of § 501(c)(3) of the Code."

## **RATIONALE**

Section 508(a) provides that, subject to certain exceptions, in order to be recognized as an organization described in § 501(c)(3), the organization must provide notice to the Secretary of the Treasury and such organization claiming exemption under § 501(c)(3) provides such notice by filing Form 1023, Application for Recognition of Exemption Under § 501(c)(3). Section 1.508-1(a)(2)(vi) provides that § 508 does not apply to a foreign organization that receives substantially all of its support from sources outside the United States. Since you are a foreign organization that receives substantially all of your support from sources outside the United States you are excepted from § 508. However, even if you are not subject to the requirements under § 508(a) to apply for recognition of tax exemption, you must nonetheless submit Form 1023 and provide a showing that you are entitled to exemption in order to obtain a written determination that you qualify as an organization described in § 501(c)(3). In order to qualify for exemption under § 501(c)(3) and obtain a written determination of exemption, you must be organized and operated exclusively for charitable, educational, or other exempt purposes within the meaning of § 501(c)(3).

Section 1.501(c)(3)-1(a)(1) explains that you cannot be exempt under § 501(c)(3) if you do not meet the organizational test under § 1.501(c)(3)-1(b) and the operational test under § 1.501(c)(3)-1(c).

### *Organizational Test*

Section 1.501(c)(3)-1(b) explains that you would not meet the organizational test if your articles empower you to engage, as a substantial part of your activities, in activities which in themselves are not in furtherance of one or more of the exempt purposes set forth in § 501(c)(3). An organization is organized exclusively for charitable purposes when its articles of organization include provisions describing the purposes for which the organization was formed that satisfy requirements of § 501(c)(3). Your articles of organization are set forth in Declaration. Declaration provides that you were organized for the purpose of creating a common investment fund benefiting Registered Charities that purchase units. The purchasing of units by Registered Charities is not a charitable purpose within the meaning of § 501(c)(3).

### *Operational Test*

Section 1.501(c)(3)-1(c)(1) of the regulations explains that you would be regarded as "operated

exclusively" for one more exempt purposes only if you engage primarily in activities which accomplish one or more of the exempt purposes specified in § 501(c)(3). The presence of a single nonexempt purpose, if substantial in nature, will destroy the exemption regardless of the number or importance of the truly exempt purposes. See Better Business Bureau of Washington D.C., Inc. v. United States, 326 U.S. 279 (1945).

An organization is operated exclusively for charitable purposes only if it is primarily engaged in activities that accomplish a charitable purpose and only an insubstantial portion of its activities (if any) are not in furtherance of a charitable purpose. An organization providing investment management assistance to one or more charitable organizations may qualify for exemption under § 501(c)(3), depending upon the circumstances. Like the organization described in Rev. Rul. 71-529, (1) your investors must be charitable organizations, (2) your investors are able to achieve diversification of investments that might not otherwise be feasible, and (3) your investors can obtain the benefits of professional management of their financial assets. However, unlike the organization described in Rev. Rul. 71-529, (1) your investors do not participate in management, (2) your investors do not participate in the selection or removal of Board, Trustee or Manager, (3) the management fee paid to Manager is not substantially less than cost, and (4) the investment management fee is not defrayed by gifts from donors.

Rev. Rul. 69-528 describes an organization created to provide investment management services that did not qualify for exemption under § 501(c)(3). The investors did not control the organization. An investor's rights were limited to acquiring an investor interest and electing to take a distribution in liquidation of its interest in the common fund. You are similar to the organization described in Rev. Rul. 69-528 in that (1) investor charities' interests are limited to investment units in a common fund, (2) investor charities have no right to participate in the development of the investment objectives, and (3) investor charities take no part in approving the resulting investment policy developed by Manager to accomplish the investment objectives.

Rev. Rul. 72-369 describes an organization that provided managerial and consulting services exclusively to charitable organizations that did not qualify for exemption under § 501(c)(3). In that case, the services were provided at a fee limited to cost. You are similar to the organization described in Rev. Rul. 72-369 in so far as the fee paid to Manager bears a relationship to costs it incurs to provide its services; however, unlike the fee charged by the organization described in Rev. Rul. 72-369, your fee is not specifically limited to cost. You indicate that Manager may derive a net profit from its services to you. Any such profits pass through Manager to C1, C2 and C3.

The fact that your services are provided solely to Registered Charities under the laws of Country is not sufficient to characterize your activity as charitable within the meaning of § 501(c)(3). Section 502 provides that an organization operated for the primary purpose of carrying on a trade or business for profit shall not be exempt under § 501(a) on the ground that all of its profits are payable to one or more organizations exempt from federal income tax under § 501(a). Investment management services are a trade or business ordinarily carried on for a profit. Even though potential net profits derived by Manager flow exclusively to the three Registered Charities that own it, you are nonetheless engaged in the trade or business of investment management on terms and conditions that do not accomplish a charitable purpose within the meaning of § 501(c)(3).



Based upon your application and the supporting documentation provided, we conclude that you are neither organized nor operated for charitable purposes. Declaration does not satisfy the organizational test. You also fail to satisfy the operational test because you provide investment management services to any Registered Charity that opts to acquire units, on terms and conditions that do not accomplish a charitable purpose. Accordingly, you do not qualify for exemption as an organization described in § 501(c)(3).

## CONCLUSION

Therefore, you have not established that you are organized and operated exclusively for exempt purposes within the meaning of § 501(c)(3).

You have the right to file a protest if you believe this determination is incorrect. To protest, you must submit a statement of your views and fully explain your reasoning. You must submit the statement, signed by one of your officers, within 30 days from the date of this letter. We will consider your statement and decide if the information affects our determination.

Your protest statement should be accompanied by the following declaration:

*Under penalties of perjury, I declare that I have examined this protest statement, including accompanying documents, and, to the best of my knowledge and belief, the statement contains all the relevant facts, and such facts are true, correct, and complete.*

You also have a right to request a conference to discuss your protest. This request should be made when you file your protest statement. An attorney, certified public accountant, or an individual enrolled to practice before the Internal Revenue Service may represent you. If you want representation during the conference procedures, you must file a proper power of attorney, Form 2848, *Power of Attorney and Declaration of Representative*, if you have not already done so. For more information about representation, see Publication 947, *Practice before the IRS and Power of Attorney*. All forms and publications mentioned in this letter can be found at [www.irs.gov](http://www.irs.gov), Forms and Publications.

If you do not file a protest within 30 days, you will not be able to file a suit for declaratory judgment in court because the Internal Revenue Service (IRS) will consider the failure to protest as a failure to exhaust available administrative remedies. Code section 7428(b)(2) provides, in part, that a declaratory judgment or decree shall not be issued in any proceeding unless the Tax Court, the United States Court of Federal Claims, or the District Court of the United States for the District of Columbia determines that the organization involved has exhausted all of the administrative remedies available to it within the IRS.

If you do not intend to protest this determination, you do not need to take any further action. If we do not hear from you within 30 days, we will issue a final adverse determination letter. That letter will provide information about filing tax returns and other matters.

Please send your protest statement, Form 2848 and any supporting documents to this address:

Internal Revenue Service

SE:T:EO:RA:T:1

\*\*\*\*\*

1111 Constitution Ave, N.W.  
Washington, DC 20224

You may also fax your statement using the fax number shown in the heading of this letter. If you fax your statement, please call the person identified in the heading of this letter to confirm that he or she received your fax.

If you have any questions, please contact the person whose name and telephone number are shown in the heading of this letter.

Sincerely,

Holly O. Paz  
Director, Rulings and Agreements